Is paying off your home mortgage early a good idea?

With proper planning, getting mortgage off your back isn't a big deal

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A decision can be made only by doing a little math and considering your lifestyle
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If finding your dream house and getting a mortgage approved is one part of buying a house, then owning it by paying back the loan is the other. Mortgage loans in the UAE are capped at about 70-75 per cent of the property value on a maximum tenure of 25 years. On proper planning, getting mortgage off your back isn't a big deal. A lot of people acquire enough wealth to close the loan, some years in. The question is when do you want to clear the loan? Few people clear the mortgage early while some drag it up to the end of the tenure. While there are advantages and disadvantages in both cases - if planned and executed well, it can bring in significant financial benefits. Some of our examples will be based on the average mortgage loan size in UAE, which sits around Dh1.5 million (at 4.5 per cent for 25 years).

Clearing your mortgage early can be a good idea because:

Savings

Usually, you probably save at least 20 per cent of your monthly income. If not, you're living paycheck-to-paycheck, and clearing yourself off debt becomes an extreme priority here. In case you have multiple loans, it's wise to adopt a snowball strategy to get rid of them. Considering a loan principal of Dh1.5 million with 4.5 per cent interest, the yearly EMI will be around Dh101,000 (of which roughly 50-60 per cent will be towards interests in the first 10 years). If you have accumulated enough wealth to square up the loan in those 10 years, it's wise to do so if you want to get rid of debt and avoid spending on interests. Squaring up the loan after 10 years will essentially save you around Dh430,000 in the long term - which is equivalent to shaving 4.5 years of debt if you were to pay the loan as per the schedule. This will get you off the burden and make way for higher savings further.

Prepayment options

If the monthly installments on the mortgage are higher than the prepayment fees then clearing it early is a good idea. Usually, banks in UAE charge 1-3 per cent of the outstanding balance on early payments (irrespective of partial or full payments) on the home mortgage. In case of a loan worth Dh1.5 million, the total amount to repay would stand at around Dh2.5 million (4.5 per cent, 25 years). After 10 years, you'd be left with Dh1.08 million balance to pay back. The pre-closure charge levied, in this case, will be a negligible Dh32,000 (considering a 3 per cent charge – highest industry standard). This is significant savings - considering the Dh430,000 savings in the long term - and the relief of a debt free life. Clearing the loan before tenure can save a lot of stress.

Investment options

If you have a lump sum of money and can't consider any investment option or can't risk your money, then clearing the mortgage loan is a good idea. This will definitely save your monthly mortgage installments in the long run.

Planning to leave UAE

If you are planning to leave UAE then clearing your existing mortgage loan is mandatory more than a choice.

Clearing home mortgage early can be a bad decision under certain cases like:

Existing Debts

If you have existing debts on credit card, personal loan or any other, then make them as your priority. Interest rates on mortgage loans in UAE is low compared to any other loan. So clearing home loan before the end of the tenure when you already have other debts in hand is a bad idea.

Emergency funds

First and foremost using your emergency funds to clear your mortgage is never a good idea. Your emergency funds must be at least six months' worth of your monthly salary. Breaking emergency funds for a mortgage loan is the riskiest thing ever. These funds can help you during uncertain times like if you lose your job or unplanned medical emergencies.

Savings/investments

If you are getting a good profit on savings or any investments then it is not right to divert your savings funds to pay off the mortgage. For example, 10 years into the loan (when you still have 15 more years to pay back Dh1.51 million balance) and have excess capital at your disposal (at least twice the regular EMI yearly expense), putting in Dh100,000 yearly deposits to a growth fund with 6 per cent year-on-year returns, you can generate a revenue of roughly Dh2.5 million in those 15 years and carrying forward - Dh2.8 million in 20 years. Which means, after paying pack the Dh1.13 million debt you'd have also generated Dh1.3 million from the fund in 15 years and in the 20th year you'd have a cumulative profit of roughly Dh2.8 million if the growth fund keeps delivering.

An alternate scenario - if you paid the excess 100,000 deposits to the loan repayment every year, you'd likely close the loan in 13 years (instead of 25, and would have saved 290,000 in interests paid). But again, you'd have missed the returns on the cumulative interests in the prospective investment - something worth considering if you have the means.

Clearing the home mortgage or keeping it, totally depends upon the individual. Even though having a debt free life brings in a sense of relief and security, but in several circumstances, it can be given quite a low priority when compared to your other debts, savings or investments. This decision can be made only by doing a little math after considering all the facts and figures based on your personal financial circumstances and lifestyle.

Nikhil Rastogi is co-founder and director of MyMoneySouq.

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